

## Message Text

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ACTION ARA-17

INFO OCT-01 ADP-00 EB-11 COME-00 TRSE-00 OMB-01 STR-08

AID-20 IGA-02 AGR-20 ABF-01 SS-14 NSC-10 L-03 H-02

CIAE-00 DODE-00 INR-09 NSAE-00 PA-03 RSC-01 USIA-12

PRS-01 RSR-01 /137 W

----- 044228

R 281530 Z MAR 73

FM AMEMBASSY SAN JOSE  
TO SECSTATE WASHDC 3602  
INFO AMEMBASSY GUATEMALA  
AMEMBASSY MANAGUA  
AMEMBASSY SAN SALVADOR  
AMEMBASSY TEGUCIGALPA

LIMITED OFFICIAL USE SAN JOSE 1081

E. O. 11652: N/A

TAGS: ETRD XK HO CS

SUBJECT: NEGOTIATION OF BILATERAL AGREEMENT WITH  
HONDURAS

GUATEMALA ALSO FOR ROCAP

REF: TEGUCIGALPA 1044

1. GOCR MINISTRY OF ECONOMY ANNOUNCED MARCH 27 THAT A TOTAL OF 160 COSTA RICAN FIRMS HAD RESPONDED TO QUESTIONNAIRE DETAILING ITEMS THEY WISHED INCLUDED IN BILATERAL WITH HONDURAS. THESE REPLIES, TOGETHER WITH THE LISTS OF ITEMS INCLUDED IN THE EXISTING HONDURAN BILATERALS WITH GUATEMALA AND NICARAGUA, WILL BE CONSIDERED AS INPUTS TO DRAFT THAT GOCR WILL TAKE TO HONDURAS FOR DISCUSSIONS WEEK OF APRIL 2.

2. VICE MINISTER OF ECONOMY JORGE OBANDO RECENTLY WARNED COSTA RICAN BUSINESSMEN THAT " THE BILATERAL LIMITED OFFICIAL USE

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WITH HONDURAS IS NOT A BARGAIN FOR COSTA RICA,"  
POINTING OUT THAT THE HONDURANS WANT TO APPLY

COMPENSATORY IMPORT DUTIES ON COSTA RICAN PRODUCTS  
IN ORDER TO COUNTERACT EFFECTS OF OCTOBER 18  
CACM AGREEMENT, WHICH SPECIFIED THAT NEARLY ALL  
COSTA RICAN IMPORTS FROM ALL OF ITS CACM PARTNERS  
MUST BE PAID FOR AT MORE EXPENSIVE "FREE MARKET"  
EXCHANGE RATE. OBANDO DID NOT MENTION POSSIBILITY  
CITED REFTEL THAT COSTA RICA REQUEST WAIVER FROM  
OTHER CACM COUNTRIES TO CONDUCT HONDURAN TRADE AT  
OFFIC EC "SNAKE;" DESIRE TO AVOID EXCESSIVE REVALUATION  
AGAINST DOLLAR AND OTHER NON- EC CURRENCIES; AND DESIRE TO RECOUP  
FOREIGN CURRENCY RESERVES LOST DURING 1972 AND EARLY 1973 SO AS  
TO BE ABLE TO REPAY AS SOON AS POSSIBLE VERY LARGE 1972 EURO-  
MARKET BORROWINGS BY STATE ENTITIES.

3. WE UNDERSTAND THAT INITIAL ROLE OF EUROPEAN MONETARY COOPER-  
ATION FUND WOULD BE THAT ORIGINALLY ENVISAGED AND REPORTED BY EC  
BRUSSELS PREVIOUSLY. WITH REGARD TO FUTURE, ITALIANS HAVE MADE  
SPECIFIC PROPOSAL FOR EXPANDED FUND, COMPLETE TEXT OF WHICH WAS  
REPORTED IN REF B. THIS ITALIAN INITIATIVE (SEE PARA H ON PAGE 3  
REF B) CALLS FOR EVENTUAL ASSIGNMENT TO FUND OF EXCLUSIVE POWER TO  
INTERVENE IN EXCHANGE MARKETS IN BOTH EC CURRENCIES AND IN DOLLARS.  
WE HAVE NO SPECIFIC INFORMATION IN ROME AS TO ROLE TO BE PLAYED BY  
NON- EC COUNTRIES IN EC JOINT FLOAT OR SWAP ARRANGEMENTS.

4. ITALIAN FINANCIAL OFFICIALS WERE PLEASED BY US OFFER OF COOPER-  
ATION AT MARCH 16 G-10 MEETING IN FORM OF SELECTIVE MARKET INTER-  
VENTION AND IN FORM OF CONDITIONING OF PHASE- OUT OF US CONTROLS ON  
IMPROVEMENT IN US BALANCE OF PAYMENTS. THEY CATEGORIZE US POSITION  
AS MODES CONTRIBUTION, BUT THEY DID NOT REALISTICALLY EXPECT MORE  
FROM US. COMMERCIAL BANKERS, WHILE ACKNOWLEDGING UTILITY OF LIM-  
ITED US COMMITMENT, CONTINUE TO WORRY ABOUT LARGE DOLLAR OVERHANG  
WHICH PERMITS MASSIVE FLOWS OF FUNDS INTO AND OUT OF INDIVIDUAL  
CURRENCIES. THEY WOULD LIKE US AND OTHERS TO DO SOMETHING SOON  
ABOUT PROBLEM.

5. ITALIAN OFFICIALS, BOTH MALAGODI AT TREASURY AND GOVERNOR CARLI  
AND OTHER BANK OF ITALY OFFICIALS, ARE SKEPTICAL OF PROSPECTS OF  
EC JOINT FLOAT, AS THEY HAVE PUBLICLY INDICATED ON NUMEROUS OC-  
CASIONS. ITALIAN VIEW HAS BEEN THAT FOR SUCH RIGID LINKING OF  
EXCHANGE RATES TO WORK THERE MUST EITHER BE CLOSE COORDINATION OF  
DOMESTIC ECONOMIC POLICIES OR MUCH GREATER FINANCING FACILITIES  
IN COMMUNITY THAN EXIST AT PRESENT. WE NOT AWARE OF ANY CLEAR  
ITALIAN VIEWS AS TO WHICH CURRENCIES MIGHT SINK TO BOTTOM OF BAND,  
ALTHOUGH THEY MAY THINK THAT DANISH KRONER, FRENCH FRANC AND  
GUILDER (BECAUSE OF DUTCH INFLATION PROBLEM) ARE CANDIDATES. CUR-  
RENCIES WHICH MIGHT RISE TO TOP COULD BE DEUTSCHE MARK AND BELGIAN  
FRANC, NOT BECAUSE OF INHERENT STRENGTH OF BALANCE OF PAYMENTS SO  
MUCH AS BECAUSE OF PSYCHOLOGY OF MARKET.

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6. IT DIFFICULT TO PREDICT WHAT ITALIANS' ROCK- BOTTOM DEMANDS FOR PARTICIPATION IN GENERAL FLOAT WOULD BE. ALTHOUGH THEY HAVE PUBLICLY COMMITTED ITALY TO REJOIN FLOAT AS SOON AS POSSIBLE AND, IN MEANTIME, TO CONCERT THEIR OWN FLOAT WITH THAT OF OTHER EC CURRENCIES, MONETARY AUTHORITIES HAVE LITTLE ENTHUSIASM FOR REJOINING EC " SNAKE." ITALIANS MAY SECRETLY HOPE THAT " SNAKE" MAY ONCE AGAIN COME APART, BEFORE PRESSURE BECOMES TOO STRONG FOR THEM TO REJOIN FLOAT. RESERVE LOSSES, PARTICULARLY MASSIVE LOSSES IN JAN AND EARLY FEB, WERE IMPORTANT IMMEDIATE CAUSE BEHIND DECISION TO FLOAT COMMERCIAL LIRA AND TO MAINTAIN SEPARATE FLOAT. HOWEVER, WE BELIEVE THAT PRIME MOTIVATION WAS DESIRE TO HAVE FREER HAND WITH MONETARY AND OTHER DOMESTIC POLICIES IN ORDER TO STIMULATE DOMESTIC ECONOMIC RECOVERY AND GROWTH OVER LONGER RUN. MAIN CONDITIONS WHICH ITALIANS WOULD LIKE TO HAVE FULFILLED ARE: (1) EVIDENCE THAT DOMESTIC ECONOMIC RECOVERY IS FULLY UNDER WAY; (2) AGREEMENT THAT EC FINANCING FACILITIES WILL BE GREATLY EXPANDED TO FINANCE ANY DISEQUILIBRIA WHICH DEVELOP; AND (3) ASSURANCES THAT CENTRAL RATE CAN STILL BE CHANGED IF THIS SHOULD PROVE NECESSARY AFTER REJOINING FLOAT. TO SOME EXTENT, TIMING OF DECISION BY UK AND IRELAND TO REJOIN FLOAT WILL INFLUENCE ITALIANS, SINCE THEY WOULD THEN BE EXPOSED TO EVEN GREATER CRITICISM THAN AT PRESENT FOR ALLEGED GO- IT- ALONE ATTITUDE.

7. WE UNAWARE WHAT PROPOSALS TOKYO MAY HAVE PRESENTED REGARDING RELATIONSHIP OF YEN TO JOINT FLOAT. WE ASSUME ITALIAN AUTHORITIES, WHO, LIKE OTHER EUROPEANS, ARE CONCERNED ABOUT JAPANESE COMPETITIVE STRENGTH, WOULD LOOK WITH DISFAVOR ON ANY ACTION BY JAPANESE AUTHORITIES WHICH WOULD HAVE RESULT OF AVOIDING FURTHER REVALUATION OF YEN, IF MARKET SIGNALS THAT THIS REQUIRED.

8. ITALIAN AUTHORITIES, PARTICULARLY GOV CARLI, CLEARLY HOPE THAT RECENT ADOPTION ( BY FORCE OF NECESSITY) OF FLOATING RATES MAY PROVE TO BE MORE PERMANENT THAN IS NOW INTENDED BY MANY COUNTRIES. THIS WOULD FIT INTO CARLI' S SCHEME FOR EVOLUTION OF MONETARY SYSTEM TOWARD LARGE ECONOMIC BLOCS FLOATING AGAINST ONE ANOTHER. ITALIANS HOPE THAT C-20 WILL EXAMINE IN GREATER DEPTH IMPLICATIONS OF FLOATING RATES, AT LEAST TO DETERMINE WHAT RULES SHOULD BE APPLIED TO FLOATS DURING TRANSITIONAL PERIOD, OR TO MORE PERMANENT FLOATS IF SYSTEM EVOLVES IN THAT DIRECTION. AS INDICATED ABOVE, ITALIANS FAVOR CONSIDERABLE DEGREE OF EXCHANGE RATE FLEXIBILITY. WE DO NOT BELIEVE, HOWEVER, THAT ITALIANS ARE IRREVOCABLY CONFIDENTIAL

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COMMITTED TO FLOATING RATES, PROVIDED THAT SUFFICIENT FLEXIBILITY IS AN INHERENT PART OF NEW SYSTEM. IN LONGER RUN, ITALIANS WOULD PROBABLY ACCEPT TIGHTER EXCHANGE RATE LINKS WITHIN EC, PROVIDED ECONOMIC COORDINATION AND FINANCING FACILITIES HAVE BEEN SUFFICIENTLY DEVELOPED TO SUPPORT SUCH RIGID LINKS. THEY MAY ALSO WANT GREATE

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